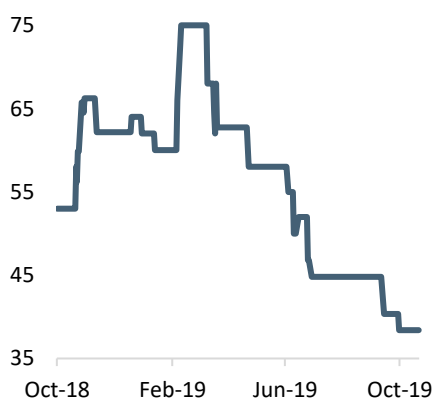


Rating	NEUTRAL
Price	₦38.4
FVE	₦51.9
52-week range	₦34.6-75
Market Cap. (₦mn)	38,400
1-month Avg. Vol	31,815.5
Curr. PE	14.25x

Presco:NL - Share Price Trend



Analyst

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Presco Plc. (PRESCO.NL)

Initial View

Earnings decline on cost inefficiencies

- Presco Plc released its Q3 19 result yesterday, recording 51% YoY decline in EPS to ₦0.63. Despite bucking the trend of three consecutive quarters of underwhelming revenue growth, underlying earnings performance reflects cost inefficiencies and finance expense pressure. As a result, Presco's 9M 19 earnings (EPS: ₦3.70) is still a long stretch from its 9M 18 EPS of ₦5.28 largely on the back of subdued product prices over the period.
- Sales back on the path of growth.** Similar to Okomu, Presco reported improvement in sales (+5.9% YoY to ₦4.85 billion). According to management, while the firm has enjoyed higher demand for its products, underlying weaknesses in sales in prior quarters stemmed from bearish product prices. However, coming into Q3 19, prices edged up, paving way for higher sales. Given the recent border closure, we do not rule out upward retracement in product prices.
- Cost inefficiencies wipe top line gains.** Due to the onset of lean season, Presco reported higher raw material cost over the period (+28.4% YoY to ₦1.5billion). However, Q3 19 cost to sales ratio of 31.8% marks the highest in seven quarters, hence we will seek further clarity from management regarding the key driver of the cost pressure. As a result, gross margin compressed 560bps to 68.2%. Elsewhere, on the heels of resurfacing Administration cost pressure (+13.7% YoY to ₦1.9 billion), operating expenses ticked higher 15% YoY to ₦2 billion. Consequently, EBIT declined 22.4% YoY to ₦1.3 billion with related margin touching a six-quarter low of 27.3%.
- Furthermore, earnings were pressured by higher interest expense following a 24.9% ramp up in short term borrowings to ₦7.9 billion. This brings debt to equity to 76% (vs 66% in Q2 19). Overall, following the confluence of higher raw material cost, operating expenses and interest expense, PBT and PAT dipped 48.4% and 51.1% to ₦904 million and ₦631.4 million respectively.
- Based on our last communicated report, we have an FVE of **₦51.9** and a **NEUTRAL** rating on the company. Presco trades at a P/E of 14.25x relative to 9.74x for Okomu and 10.48x for Bloomberg MENA peers.

Summary of Results

Income statement – (N' million)					
	Q3 19	YoY growth	QoQ growth	9M 19	9M 18
Revenue	4,849	5.91%	-3.84%	15,397	16,236
Cost of sales	1,543	28.42%	17.69%	3,676	3,944
Gross profit	3,306	-2.10%	-11.40%	11,721	12,292
OPEX	2,047	15.05%	0%	5,736	4,581
Operating profit	1,326	-22.42%	-27%	6,260	8,031
Finance expense	421	29.42%	-8.03%	1419	929
PBT	904	-48.41%	-34%	4,841	7,472
PAT	631	-51.07%	-32%	3,702	5,280

Key Ratios	Q3 19	Q3 18	Change(pps)	9M 19	Change(pps)
Gross margin	68.18%	73.76%	-5.58%	76.13%	2.69%
EBIT margin	27.34%	37.32%	-9.98%	40.66%	-0.19%
PBT margin	18.65%	38.29%	-19.64%	31.44%	-5.05%
PAT margin	13.02%	28.19%	-15.17%	24.04%	-77.07%
Effective tax rate	30.17%	26.37%	3.80%	23.53%	200.59%

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to real portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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